Office of Inspector General

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Homeland Security

February 8, 2005

MEMORANDUM FOR: Karen E. Armes
Acting Regional Director
FEMA Region IX

Robert J. Lastrico

FROM: Robert J. Lastrico
Field Office Director
Office of Audits

SUBJECT: *Audit of Santa Monica Hospital Medical Center*
Woodland Hills, California
Public Assistance Identification Number 037-90329
FEMA Disaster Number 1008-DR-CA
Audit Report Number DS-08-05

The Office of Inspector General (OIG) audited public assistance funds awarded to the Santa Monica Hospital Medical Center, Woodland Hills, California (Medical Center). The objective of the audit was to determine whether the Medical Center expended and accounted for Federal Emergency Management Agency (FEMA) funds according to federal regulations and FEMA guidelines.

The Medical Center received an award of $8.1 million from California Office of Emergency Services (OES), a FEMA grantee, for debris removal, emergency protective measures, and permanent repairs to Medical Center facilities damaged by the Northridge earthquake on January 17, 1994. The award provided 100 percent Federal funding for emergency work until January 25, 1994, and 90 percent funding thereafter for nine large and seven small projects.[1] The audit covered the period January 17, 1994, to April 4, 2002, and included a review of all projects (see Exhibit A).

The OIG performed the audit under the authority of the Inspector General Act of 1978, as amended, and according to *Government Auditing Standards* issued by the Comptroller General of the United States. The audit included review of FEMA, OES, and Medical Center records, a judgmental sample of project expenditures, and other auditing procedures considered necessary under the circumstances.

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[1] Federal regulations in effect at time of the disaster set the large project threshold at $42,400.

RESULTS OF AUDIT

The OIG questions $1,584,565 of costs claimed by the Medical Center (FEMA's share of this amount is $1,426,109). Specifically, the OIG questions $629,904 for repair work not earthquake related, $518,185 of duplicate benefits, $359,777 of repairs subject to limited use requirements, and $76,699 of ineligible project costs.

Finding A – Repair Work Not Earthquake Related

The Medical Center's claim for three projects included $629,904 in costs that were not disaster related and therefore not eligible for FEMA reimbursement. According to 44 CFR § 206.223[2], an item of work must be required as a result of a major disaster to be eligible for financial assistance. Further, this regulation generally does not allow for the funding of damage costs caused by negligence. In addition, 44 CFR § 206.226 provides that eligible damaged facilities are to be restored on the basis of the design of the facilities existing immediately prior to the disaster. Lastly, 44 CFR § 13.20 requires a subgrantee to maintain accounting records that identify how FEMA funds are used. The following paragraphs identify the projects, the ineligible items of work, and the costs questioned by the OIG.

- For project 76880, the Medical Center claimed $214,259 for repair work not related to disaster damage as follows:

    - According to consulting engineer reports dated January 25, 1994 and February 11, 1994, a January 20, 1994 memorandum from the Medical Center's President and Chief Executive Officer to the Medical Center's Board of Directors, and a February 8, 1994 Medical Center internal report, the Merle Norman Pavilion, a six-story facility, suffered exterior disaster damage (cracks) as a result of the earthquake. However, rather than patching and waterproofing the damaged areas, the Medical Center patched the cracks and applied a waterproofing/coating finish to the entire exterior of the Pavilion at a cost of $183,349. Medical Center records did not include individual costs items for patching and applying the waterproofing/coating finish. In addition, the Medical Center could not locate contractual documents related to the work, including documents that identified specific tasks performed and related costs.

      The Medical Center's reasoning for applying the waterproofing/coating finish was documented in a February 1, 1994 meeting between the Medical Center's architect, the coating manufacturer, and contractor engaged to do the work. The minutes of that meeting indicated that previous exterior waterproofing/coating applied to correct storm-related damage was 97 percent complete prior to the earthquake. The coating manufacturer indicated that in order to maintain the 5-year product warranty, it would be necessary to repair the exterior surfaces by patching all cracks and applying one coat of waterproofing/coating paint to all exterior surfaces of the building.

[2] Revised as of October 1, 1993.

While acknowledging the reasoning above, the OIG found no evidence supporting the need to apply the finish to the entire building so as to restore the Pavilion's damaged areas to pre-disaster condition. Contrarily, we concluded that the product manufacturer and contractor had a vested interest in performing the work. While the Medical Center's primary reason for performing the work was to maintain the product warranty, the warranty covered the costs of materials but excluded labor and subsequent moisture damage costs. Thus, the value of the warranty was substantially less than the costs incurred to apply it. Further, the Center had no documentation justifying the work as necessary to restore the pre-disaster condition of the Pavilion. Therefore, the OIG questions $183,349 for that portion of the project related to the waterproofing of the entire building.

- ➢ The Medical Center claimed $28,960 to reseal 147 windows and $1,250 in related consultant fees. This work was required to correct pre-disaster moisture problems. Since the work corrected a pre-disaster condition, the OIG questions the $30,210 ($28,960 plus $1,250) claimed for the work.

- ➢ The Medical Center claimed $700 to paint a wall adjacent to the Pavilion because its color did not match that of the Pavilion. Because this work was not necessitated by the disaster, the OIG questions the $700 in costs claimed by the Medical Center.

- Project 22802 provided funding for structural and non-structural repairs to the Medical Center's Tower Building and for replacement of medical equipment, contents, and supplies. The Medical Center's claim included $407,100 in building upgrades and other costs not related to the disaster as follows:

  - ➢ The Medical Center claimed $174,770 for ineligible upgrades to the third floor of the Tower Building. The Medical Center retained an architectural consulting firm to oversee earthquake restoration plans and to provide planning and engineering services. In September 1994 and June 1996, the architects reported that costs increases of approximately $225,000 were related to "betterment projects that were implemented concurrently with the earthquake repairs project." The betterments identified by the architects and questioned by the OIG included raising a ramp to provide access from the third floor of the Tower Building to the adjacent Pavilion. FEMA's financial review of submitted costs resulted in the deobligation of $231,407 related to this work; however, after a Medical Center appeal, FEMA reinstated $181,177. FEMA's appeal analysis states that the Medical Center provided invoices, check requests, or check photocopies to support that the permanent repairs were earthquake-related but goes on to say that in some cases, betterment costs were allocated on a 70/30 percent ratio of eligible costs to betterment costs. While FEMA reinstated $181,177, the OIG found no documentation to support the expenditure of $174,770, for the cost of raising the ramp; an item of work not needed to restore the Building to its pre-disaster condition.

  - ➢ The Medical Center claimed $129,075 for the replacement of a roof that was not damaged by the earthquake. Medical Center records reviewed by the OIG showed that 8-months after the earthquake, on September 27, 1994, a Medical Center contractor inspected the roof and

determined that the roof had exceeded its anticipated life expectancy and was beyond any reasonable repair. The contractor also noted that the existing membrane on the 2nd and 3rd floor roofs showed signs of serious deterioration and was splitting in various places, thus allowing water to penetrate the membrane and causing the roof to leak. A June 1996 letter from the Medical Center's architect furthered the OIG's understanding of this project by identifying the roof replacement as a betterment project. We found no project records indicating that the roof was damaged as a result of the earthquake and therefore, we question the $129,075 claimed by the Medical Center.

- The Medical Center claimed $38,196 to upgrade a high voltage air-conditioning motor ($23,432) and a mammography unit ($14,764). FEMA funding had been provided and expended by the Medical Center to restore these items to their pre-disaster condition. However, 8 months later, the Medical Center upgraded the equipment and claimed the additional $38,196 that the OIG is now questioning.

- The Medical Center claimed $28,285 for an inventory of 299 light fixtures to be used in the future. Medical Center records supporting the cost did not indicate that the purchase represented a replacement of a light fixture inventory that existed prior to the disaster. Therefore, we are questioning the costs claimed.

- The Medical Center claimed $24,289 to repair damage caused by workers' negligence. These charges included $15,708 for repainting a smoke damaged area caused by the burning of epoxy material in the building, and $8,581 for repairing hospital beds damaged while in storage. These costs were not incurred as a result of the disaster and are not eligible for FEMA reimbursement.

- The Medical Center claimed, and the OIG questions, $12,485 for costs not supported with documentation proving that the charges were disaster related. This included $10,835 for a roof deck system and $1,650 for a 5-year warranty.

- For project 76955, the Medical Center claimed $8,545 in ineligible building maintenance costs. Specifically, the Medical Center charged the project the 2nd year billing on a pre-disaster 3-year maintenance contract. This cost was not disaster-related and thus questioned by the OIG.

Finding B - Duplicate Benefits

The Medical Center's claim for all projects included $518,185 in duplicate benefits resulting from the disproportionate allocation of insurance benefits. The Medical Center's records for the projects showed that the insurance reimbursement resulted in a more favorable financial benefit than the assumptions used to secure funding for disaster damage, and the Medical Center did not follow FEMA's stated methodology in allocating insurance benefits. Section 312(a) of the Robert T. Stafford Disaster Relief and Emergency Assistance Act states that no entity is eligible for disaster assistance with respect to any part of a loss for which it has received financial assistance from insurance. Policies to prevent duplication of benefits, including benefits between its own program

and insurance benefits, are provided in 44 CFR § 206.191. Further, according to 44 CFR § 206.250(c), actual and anticipated insurance recoveries shall be deducted from otherwise eligible costs. In the case of the Medical Center, the anticipated insurance recovery was $9,671,286, the face amount of the policy.

Insurance settlement amount. At the time of the disaster, the Medical Center and other affiliates were covered under a $50 million blanket insurance policy administered by the UniHealth American Foundation.[3] In a June 27, 1994 letter to OES, FEMA recommended the use of the policy face value of $50 million in applying the insurance recovery to disaster damage rather than the settlement amount of $46.7 million.[4] Nonetheless, UniHealth America settled for the lesser amount. UniHealth America's settlement logic was based on a determination of funding needs by quarter through June 1997 using present value factor of 6.36 percent (see Exhibit B). The Settlement Agreement and Release of Claims executed on November 24, 1994 between Unihealth and the 13 insurers noted in provision number 11 that "Unihealth further acknowledges that its ultimate losses, damages, costs of repair and expenses is anticipated to exceed the amount of the payment accepted by it pursuant to this Agreement, and acknowledges that it is possible that it could recover a greater amount under the insurance policies in the future if it did not enter into this Agreement at this time. Its acceptance of this settlement and execution of this Agreement, however, constitutes a release, waiver, and extinguishment of such further additional claims and is an acknowledgement of payment and satisfaction of such claims."

The OIG determined that by settling the insurance claim, the Medical Center received a more favorable financial benefit than the initial assumptions anticipated and presented for federal funding. Firstly, the value of the insurance benefit was based on a January 1994 present value factor using 6.36 percent, but U.S. Treasury Department yield data from the Department's Bureau of Public Debt showed that rates were rising during time period the insurance claim was settled. During the period September 1, 1994 through December 31, 1994, 3-year security investment rates ranged from 6.4 percent to 7.8 percent. Therefore, investing the funds in a rising interest rate environment would have produced a value of greater than $50 million over the investment period.[5] Secondly, since the building projects and expenditures did not occur as soon as anticipated, the Medical Center was provided a longer investment period for the funds received. Thus, in determining the allocation of Medical Center insurance proceeds, the OIG used the face amount of the proceeds rather than the present value amount. Under this blanket policy, the Medical Center should have received

[3] UniHealth America, Inc.'s blanket insurance policy to UniHealth American Foundation included the following entities that were also FEMA subgrantees: Facey Medical Foundation, Glendale Memorial Hospital and Health Center, Northridge Hospital Medical Center, Santa Monica Hospital Medical Center, and Valley Hospital Medical Center.

[4] The insurance policy had a face value of $50 million; the underlying $10 million policy was honored immediately by the insurer. Instead of receiving the remaining $40 million over time or as progressive rebuilding funds were required to meet costs incurred, UniHealth America, Inc. and the insurance company's accountants calculated the discounted policy value, i.e., the current value of insurance benefit payments due in the future. The net amount equaled $36.7 million. That second payment was made in December 1994. The total of the two payments reflected the present value of $46.7 million (see Exhibit B).

[5] U.S Treasury 3-year security investment rates averaged 7.6361 for the period from September 1, 1994 through December 31, 1994. This average rate would have resulted in a settlement amount of $46.1 million instead of $46.7 million. When applying the average rate of 7.6371 percent to the payment schedule used for the settlement, the $46.7 million received by UniHealth America would be worth $50.7 million.

$9,671,286 instead of $9,071,040 in insurance reimbursements to cover insured disaster damage costs. FEMA then could provide funding for eligible damage not covered by insurance.

Medical Center allocation methodology. Early in its recovery efforts, the Medical Center informed FEMA that it planned to allocate its $9,071,040 insurance proceeds primarily to damaged facilities not eligible for FEMA funding and to business interruption losses. In the previously mentioned letter to OES, FEMA notified the grantee and subgrantee that it disagreed with the Medical Center's proposed allocation methodology and noted that the methodology was not permitted under the Stafford Act and applicable regulations. FEMA officials stated that the insurance proceeds should be allocated proportionally among all insured properties based on sustained insured damages. Neither FEMA nor the OIG questioned the eligibility of business interruption losses covered by the Medical Center's insurance policy. However, such losses are not eligible for FEMA funding[6] and do not receive special treatment when allocating insurance benefits. As such, insurance benefits must be allocated proportionally among all insured property and business interruption losses, just as FEMA stated in its letter.

FEMA, OES, and the Medical Center officials met at least twice to discuss this insurance benefit allocation issue, once on August 29, 1994 and again on November 17, 1998. Minutes from those meetings showed that FEMA continuously stressed the need for insurance benefits to be allocated proportionally based on sustained insured damages. Project records also showed that FEMA requested the UniHealth American Foundation to provide updated information on the total insured loss; however, there was no evidence in the files showing that the requested information was ever provided.

Despite FEMA's non-concurrence with the proposed allocation methodology, the Medical Center allocated $1,253,161 to business interruption and $7,817,879 to large project 22802 (total insurance recovery $9,071,040). The Medical Center did not allocate insurance benefits to any other insured areas or categories of disaster damages as recommended by FEMA.

Medical Center records showed that actual business interruption losses subject to insurance reimbursement totaled $704,423 or $548,738 less than the amount allocated by the Medical Center.[7] This excess allocation provided insurance benefits that should have been allocated to insured disaster damage; thus decreasing costs otherwise eligible for FEMA reimbursement. Using FEMA's recommended allocation methodology, the OIG recalculated FEMA eligible costs by allocating insurance benefits proportionally among all insured property based on sustained insured damage.[8] We determined that the allocation to project 22802 should have been $6,637,105 or $1,180,774 less than the amount actually allocated.[9] This excess allocation decreased eligible disaster costs for project 22802 with a reverse affect on other projects.

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[6] 44 CFR § 205.76250 (a)(17) Loss of revenue - Replacement of revenues lost as the result of a major disaster or emergency is not eligible for grant assistance.
[7] $1,253,161 minus $704,423.
[8] Allocated proportionally among all insured property using the policy's face value.
[9] $7,817,879 minus $6,637,105.

Table 1 below shows OIG's re-allocation of insurance benefits. The column labeled "Excess Funding" shows benefits or costs covered by insurance and also reimbursed by FEMA, and the column labeled "Under Funding" shows eligible disaster costs not reimbursed by FEMA. The net of these two columns represents a duplicate benefit to the Medical Center of $518,185 ($1,698,959 minus $1,180,774).

Table 1 - OIG's Re-allocation of Insurance Benefits

Project Number	Excess Funding	Under Funding
Large Projects		
14524	$ 206,714	
22551	38,518	
22588	374,156	
22589	411,808	
22802		$1,180,774
22803	134,311	
76880	449,698	
76955	28,689	
81870	28,658	
Small Projects	26,407	
Totals	$1,698,959	$1,180,774

By using FEMA's allocation methodology, the OIG questions $518,185 of disaster funding claimed by the Medical Center because these losses were honored by insurance benefits.

Finding C – Repairs Subject to Limited Use Requirements

The Medical Center's claim for project 22802 included $359,777 for ineligible work on the 8th floor of the Tower Building, a location that was vacant and not in use at the time of the disaster. The work included constructing general office space and patient rooms ($190,942); procuring and installing flooring ($135,209); repairing, purchasing, and installing televisions ($17,820); and painting the 8th floor to match the 6th floor ($15,806). According 44 CFR § 206.226, eligible facilities can be restored on the basis of the design of the facilities existing immediately prior to the disaster. Further, facilities that are in limited use or used for purposes other than designed are generally eligible for disaster assistance only to the extent necessary to restore pre-disaster capacity for such uses. While FEMA regulations allow for the funding of disaster repairs to facilities that are temporarily inoperative or where an active use is firmly established in an approved budget and use is scheduled within a reasonable time, the Medical Center could not provide any evidence of a pre-disaster plan for the use of the 8th floor for medical purposes.

The OIG viewed a Medical Center videotape of damage to the 8th floor recorded 11 days after the earthquake. The videotape showed that the floor suffered only minor disaster damage and was not in active use for any medical purposes at the time of the disaster. Rather, the floor was available as a storage area. In a March 31, 1997 meeting with FEMA officials, a Medical Center staff member stated that there were no plans to repair the 8th floor and that prior to the disaster, the space was

empty and not providing patient care services. The Medical Center justified the work accomplished on the 8th floor on the basis that the floor was licensed as a Medical/Surgical Unit. However, the OIG could find no evidence that the floor had ever been used for patient care services, and the Medical Center could not provide any pre-disaster documentation that an active use was firmly established in an approved budget for the use of the 8th floor as a Medical/Surgical Unit. Therefore, the OIG questions the $359,777 claimed to build-out the 8th floor as a Medical/Surgical Unit.

Finding D – Ineligible Project Costs

The Medical Center's claim for six projects included $76,699 in ineligible project charges.

- For projects 22588 and 81870, the Medical Center claimed $39,833 in equipment/material rental costs for 6 months longer than needed to satisfy the combined scope of work. The projects provided emergency funding for a temporary power source (a generator and related cabling) to operate a cardiac catheterization unit (CU) until the main power source was restored. While Medical Center records showed that the CU was reconnected to the main power source in July 1994, the claim included rental costs for an additional 6 months (January 1995). The unnecessary rental costs totaled $28,182 under project 22588 for the generator and $11,651 under project 81870 for the cabling. According to 44 CFR § 206.223(a)(1), to be eligible for financial assistance, an item of work must be required as a result of a disaster. According to Office of Management and Budget Circular A-87, Attachment A, Subpart C, a cost must be necessary and reasonable to be eligible for federal assistance. Because the Medical Center could not justify the monthly rental costs incurred after the main power source was reconnected, the OIG is questioning $39,833 as costs not required as a result of the disaster and not necessary or reasonable.

- For two small projects and one large project, the Medical Center claimed $22,905 in disaster related repair and consulting costs for residential rental units owned by the Medical Center. While these units may have been damaged during the earthquake, they were not eligible for FEMA funding under federal regulations. According to 44 CFR § 206.221, eligible costs for medical facilities include costs necessary or appropriate to provide outpatient and rehabilitation medical services, long term care, and administrative support services. Since the rental units were not used for medical related services, the OIG questions repair costs of $15,169 and $7,340 for small projects 75663 and 75637, respectively, and $396 in related consulting fees claimed under large project 22802.

- The Medical Center claimed $11,909 more in building repair costs under project 22803 than was eligible for FEMA reimbursement. Prior to the earthquake, the Medical Center entered a partnership agreement with two other entities for the ownership of a medical office building. While the agreement did not specify legal responsibility for maintenance and repair of the building, it gave the Medical Center a 40 percent ownership interest in the building and a 40 percent share of the profit or loss from occupant operations.

Disaster-related repair costs totaled $19,848 and were funded by FEMA. However, 44 CFR § 206.223 (3) states that in order to be eligible for financial assistance, an item of work must be the legal responsibility of an eligible applicant. Since the partnership agreement gave the Medical Center only 40 percent interest in the building, we concluded that only 40 percent of the repair costs, or $7,939, should have been funded by FEMA. Therefore, the OIG questions the $11,909 difference between the claimed amount and the FEMA eligible amount ($19,848 minus $7,939).

- The Medical Center's claim included a $2,052 duplicate payment to a consultant for project 22802.

Since Medical Center records did not substantiate that the claimed costs identified above were: (1) incurred as a direct result of the disaster, (2) associated with eligible medical facilities, or (3) the Medical Center's legal responsibility, the OIG questions $76,699.

RECOMMENDATION

The OIG recommends that the Regional Director, FEMA Region IX, in coordination with OES disallow $1,584,565 of costs claimed by the Medical Center.

DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOW-UP

The OIG discussed the results of this audit with the Medical Center on July 26, 2004. Those officials generally agreed with the findings and recommendation. The OIG also notified OES officials of the audit results on July 16, 2004 and FEMA Region IX officials on August 31, 2004.

Please advise this office by April 11, 2005, of the actions taken to implement the recommendation in this report. Should you have any questions concerning this report, please contact me at (510) 627-7011. Key contributors to this assignment were Curtis Johnson, Ravi Anand, and Humberto Melara.

Schedule of Audited Projects
Santa Monica Hospital Medical Center, Woodland Hills, California
Public Assistance Identification Number 037-90329
FEMA Disaster Number 1008-DR-CA

Project No.	Amount Awarded	Questioned Costs	Finding Reference
Large Projects:			
14524	$ 367,742	$ 206,714	B
22551	68,523	38,518	B
22588	693,802	402,338	B & D
22589	732,602	411,808	B
22802	4,758,777	(411,449) [10]	A, B, C, & D
22803	250,846	146,220	B & D
76880	1,014,267	663,957	A & B
76955	59,583	37,234	A & B
81870	62,633	40,309	B & D
Small Projects	69,487	48,916	B & D
Totals	$8,078,262	$1,584,565	

Finding Reference Legend:

A. Repair Work Not Earthquake Related
B. Duplicative Benefits
C. Repairs Subject to Limited Use Requirements
D. Ineligible Project Costs

[10] Adjusting the Medical Center's insurance allocation using the methodology recommended by FEMA resulted in this project adjustment (See findings A, B, C, and D for details).

Exhibit B

UniHealth America's Calculation of Present Value
Northridge Earthquake – January 17, 1994

Balance Date	Waiting Period	Funds Due	Cost Net of Deductible & Advance	Days From 11/01/94	Years	Present Value Factor @ 6.360%	Present Value
Through:							
08/31/94	0	11/1/94	$2,023,466	0	0	1.0000	$2,023,466
Month of:							
09/30/94	0	11/1/94	3,508,207	0	0	1.0000	3,508,207
Quarter:							
12/31/94	45	02/14/95	4,606,125	106	0.29	0.9823	4,524,597
03/31/94	45	05/15/96	2,417,703	196	0.54	0.9673	2,338,644
06/30/95	45	08/14/95	1,358,913	287	0.80	0.9519	1,293,549
09/30/96	45	11/14/95	2,914,113	379	1.05	0.9373	2,731,398
12/31/95	45	02/14/96	2,914,113	471	1.31	0.9224	2,687,978
03/31/96	45	05/15/96	2,461,142	562	1.56	0.9083	2,235,455
06/30/96	45	08/14/96	2,403,000	653	1.81	0.8944	2,149,243
09/30/96	45	11/14/96	340,000	745	2.07	0.8802	299,268
12/31/96	45	02/14/97	4,957,700	837	2.33	0.8662	4,294,360
03/31/97	45	05/15/97	8,346,900	927	2.58	0.8529	7,119,071
06/30/97	45	08/14/97	1,748,618	1,018	2.83	0.8399	1,468,664
09/30/97	45	11/14/97	0	1,100	3.08	0.8270	0
12/31/97	45	02/14/98	0	1,202	3.34	0.8139	0
03/31/98	45	05/15/98	0	1,292	3.59	0.8014	0
06/30/96	45	08/14/98	0	1,363	3.84	0.7892	0
09/30/98	45	11/14/98	0	1,475	4.10	0.7766	0
12/31/98	45	02/14/99	0	1,567	4.35	0.7647	0
03/31/99	45	05/15/99	0	1,657	4.60	0.7530	0
06/30/99	45	08/14/99	0	1,748	4.85	0.7411	0
09/30/99	45	11/14/99	0	1,840	5.11	0.7297	0
12/31/99	45	02/14/00	0	1,932	5.37	0.7181	0
03/31/00	45	05/15/00	0	2,023	5.62	0.7071	0
Total			$40,000,000				$36,673,900